IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1924.

Kansas City Terminal Railway Company, Illinois Trust & Savings Bank, Charles G. Hutcheson, The Atchison, Topeka and Santa Fe Railway Company, Chicago, Milwaukee & St. Paul Railway Company, Union Pacific Railroad Company, Chicago, Burlington and Quincy Railroad Company, The Kansas City Southern Railway Company, Wabash Railway Company, The Chicago, Rock Island and Pacific Railway Company, and Missouri Pacific Railroad Company, Petitioners,

VS.

Central Union Trust Company of New York, Trustee under the Consolidated Mortgage of Missouri, Kansas and Texas Railway Company, Central Union Trust Company of New York, Trustee under the Trust Agreement securing the two-year notes of Missouri, Kansas & Texas Railway Company, The Farmers' Loan & Trust Company, Trustee under the First and Refunding Mortgage of Missouri, Kansas & Texas Railway Company, The New York Trust Company, Trustee under General Mortgage of Missouri, Kansas & Texas Railway Company, B. F. Edwards, Trustee under General Mortgage of Missouri, Kansas & Texas Railway Company, Bankers Trust Company, Trustee under Second Mortgage of Missouri, Kansas & Texas Railway Company, Columbia Trust Company, Trustee under the First Mortgage of The Missouri, Kansas & Eastern Railway Company, Central Union Trust Company of New York, Trustee under Second Mortgage of Missouri, Kansas & Eastern Railway Company, The Farmers' Loan & Trust Company, Trustee under the St. Louis Division Refunding First Mortgage of the Missouri, Kansas & Texas Railway Company, Central Union Trust Company of New York, Trustee under First Extension Mortgage of Missouri, Kansas & Texas Railway Company, the Farmers' Loan & Trust Company, Trustee under Southwestern Coal & Improvement Company First Mortgage, Missouri-Kansas-Texas Railroad Company, Francis F. Randolph and Hugo W. Blumenthal, Respondents.

PETITION FOR WRIT OF CERTIORARI.

To the Honorable the Chief Justice and Associate Justices of the Supreme Court of the United States:

Your petitioners, Kansas City Terminal Railway Company, Illinois Trust & Savings Bank, Charles G. Hutcheson, The Atchison, Topeka and Santa Fe Railway Company, Chicago, Milwaukee & St. Paul Railway Company, Union Pacific Railroad Company, Chicago, Burlington and Quincy Railroad Company, The Kansas City Southern Railway Company, Wabash Railway Company, The Chicago, Rock Island and Pacific Railway Company and Missouri Pacific Railroad Company, respectfully show as grounds for the issuance of a writ of certiorari to the United States Circuit Court of Appeals for the Eighth Circuit:

The United States Circuit Court of Appeals for the Eighth Circuit, by an order dated January 22, 1925, in a cause then pending before it, certified to this court three questions or propositions of law, concerning which it desired the instruction of this court for their proper decision.

The cause in which the questions arose was entitled *"Kansas City Terminal Railway Company, et al., Appellants,* v. *Central Union Trust Company of New York, et al., Appellees, No.* 6457."

The questions certified were as follows:

> Question I. Is a plan of reorganization of a railway company sufficient as to unsecured creditors and binding upon them which does not give

precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?

Question II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditor, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?

Question III. Is such offer as to such creditors fair and binding if it consists only of the same grade of securities as offered the stockholders, the difference being that the right of the stockholder to participate is conditioned upon the payment of an assessment or the payment of a relatively greater assessment than that asked of such creditors, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances?

A copy of the certificate of the Circuit Court of Appeals is attached as an appendix.

The certificate was docketed in this court on the 2nd day of February, 1925, as No. 881, October Term, 1924.

This petition is in the nature of an application that the whole record and cause may be sent up to this court for its consideration in accordance with Section 239 of the Judicial Code and Rule 37 of the Rules of this court. There is furnished herewith as required by the statute and the rules of this court a certified copy of the entire transcript of the record in the case.

The reasons for this petition or application are two: (1) The public importance of the questions requires an authoritative disposition of them. Such a disposition can be made by this court with greater convenience to itself and with more satisfactory results by a decision based upon the specific facts in the record than is possible by theoretical answers based upon assumed facts which are necessarily incomplete. (2) Another important question not certified by the Circuit Court of Appeals is involved in the case. It could not have been certified by the Circuit Court of Appeals without detailing substantially all of the facts in the record and thus virtually calling upon this court for a determination of the whole case. It was, perhaps, for this reason that the question was not certified. The question is of dignity and importance comparable with the dignity and importance of those certified, however, and should be considered and disposed of by this court. The nature of the question and the manner in which it arises will be made clear in the brief filed herewith.

Wherefore, your petitioners respectfully pray that a writ of certiorari may be issued out of and under the seal of this court directed to the United States Circuit Court of Appeals for the Eighth Circuit, commanding the said court to certify and send to this court a full and complete transcript of the record and all the proceedings in the said Circuit Court of Appeals in the said cause therein entitled, *"Kansas City Terminal Rail-*

way Company, et al., Appellants, v. *Central Union Trust Company of New York, Trustee, et al., Appellees, No. 6457,*" to the end that this court may decide the whole matter in controversy in the same manner as if it had been brought to this court for review by writ of error or appeal—all as provided in Section 239 of the Judicial Code and Rule 37 of the Rules of this court.

EDWARD J. WHITE,
N. H. LOOMIS,
BRUCE SCOTT,
GARDINER LATHROP,
SAMUEL W. SAWYER,
Counsel for Petitioners.

H. H. FIELD,
W. F. DICKINSON,
N. S. BROWN,
F. H. MOORE,
Of Counsel.

State of Missouri, County of Jackson, ss.

Samuel W. Sawyer, being duly sworn, on his oath says, that he is one of counsel for petitioners and that the facts stated in the foregoing petition are true to the best of his knowledge and belief.

Samuel W. Sawyer.

Subscribed and sworn to before me this 7th day of April, 1925.

My term expires June 14, 1927.

(Seal) Kittie Kilburn,
Notary Public.

The foregoing petition or motion is in my opinion well founded in law and is not interposed for delay.

SAMUEL W. SAWYER,
Of Counsel for Petitioners.

IN THE

SUPREME COURT OF THE UNITED STATES.

OCTOBER TERM, 1924.

KANSAS CITY TERMINAL RAILWAY COMPANY ET AL., PETITIONERS,

VS.

CENTRAL UNION TRUST COMPANY OF NEW YORK, TRUSTEE, ET AL., RESPONDENTS.

BRIEF IN SUPPORT OF PETITION FOR CERTIORARI.

STATEMENT.

In the consolidated receivership and foreclosure suits in the United States District Court for the Eastern District of Missouri growing out of the financial troubles of the Missouri, Kansas & Texas Railway Company, the petitioners filed an intervening petition in which they claimed that certain 200-year contracts to which they were parties with the Missouri, Kansas & Texas Railway Company, providing for the joint operation of the union passenger station and a large system of terminal facilities in Kansas City, Missouri, were, by reason of their character and the circumstances of their execution, entitled to priority over the mortgages of the Missouri, Kansas & Texas Railway Company.

The relief prayed by this intervention was denied by the District Court and the decree was affirmed by the Circuit Court of Appeals for the Eighth Circuit (*Kansas City Terminal Railway Company, et al.*, v. *Central Union Trust Company, et al.*, 294 Fed. 32), and a writ of certiorari was denied by this court (264 U. S. 588).

Subsequently, the property was sold under the foreclosure decree. The purchasers bought in pursuance of a re-organization plan, which provided for the acquisition of the property by a new corporation in whose securities the stockholders, both preferred and common, of the old Missouri, Kansas & Texas Railway Company were to share upon terms provided in the plan. The foreclosure decree provided that any corporation which might become the purchaser and in which the stockholders of the old company were to have any interest must file with the Master proof of an offer of participation to creditors. The new Missouri-Kansas-Texas Railroad Company, which became the purchaser of the property, filed proof of a general offer to creditors.

Upon motion to confirm the sale, the appellants objected to the confirmation of the sale on the ground that the offer to creditors made by the new company was not fair and adequate under the decision of this court in *Northern Pacific Railroad Co.* v. *Boyd*, 228 U. S. 482, and, even if fair and adequate as to creditors generally, was not appropriate to the petitioners' claims, and was not fair and adequate as to them. The petitioners' objections were overruled by the District Court and the sale was confirmed. The petitioners appealed to the Cir-

cuit Court of Appeals for the Eighth Circuit and, after argument there, the certificate of questions referred to was issued by that court.

I.

The importance and breadth of the questions make a decision of the entire case on a full record desirable.

It is unnecessary to emphasize the importance of the questions. They are of similar character to the questions previously before this court in *Louisville Trust Co.* v. *Louisville, etc. Ry. Co.*, 174 U. S. 674; *Northern Pacific Railroad Co.* v. *Boyd*, 228 U. S. 482; *Kansas City Southern Railway Company* v. *Guardian Trust Company*, 240 U. S. 166. The considerations involved are similar in some respects to those involved in the case of *St. Louis Company* v. *Wabash Railroad Company*, 217 U. S. 227, where this court in assuming jurisdiction on writ of certiorari, says:

> "It is not a question of the payment of money, but of the extent of the use belonging to one railroad company in the tracks, right of way and terminal facilities of another, as well as the rights of access by the one company to industries established along the line of the other. This, in view of the increasing number of industries in a great and growing city like St. Louis, is of constantly enlarging importance, and ought, so far as possible, to be settled. It seems to us that both the private interests of the railroad companies, and of the separate industries and the *greater interests of the public call for the granting of the writ of certiorari* and it is, therefore, so ordered."

In the Boyd case, this court determined that a stockholders' organization could not stand unless a fair offer to creditors was made, but, as no offer at all had been made in that case, it was not necessary for this court to determine finally what could constitute a fair offer, though the court used language which might serve as a guide in subsequent cases.

The case at bar requires a definite determination as to whether an offer actually made is a fair and adequate offer. It is highly desirable that, in the determination of this question, an authoritative rule should be laid down by which the participants in future reorganizations may determine what is necessary to constitute a fair offer and, consequently, what is the measure of their respective rights. The record in this case furnishes a thoroughly adequate background for the determination of this question and the enunciation of principles which may be of inestimable benefit in future reorganizations.

The questions certified by the Circuit Court of Appeals have been very carefully framed and are of such a character that they can be answered as theoretical questions or propositions of law and without reference to other facts than those certified by the Circuit Court of Appeals. We do not believe, however, that such a determination of the questions will be as satisfactory to this court as would the consideration of the issues in their practical as well as theoretical aspects, and we do not believe that this court, by merely answering the questions, can lay down guiding principles with the

same degree of clearness as by deciding the whole case upon the entire record.

The oral evidence in the record is brief and the documents which have to be carefully considered are comparatively few. Most of the record consists of documents which had to be in the record for purposes of reference and for proof of their own existence, but whose contents need little, if any, consideration. Consequently, to examine all pertinent parts of the record will consume but a small amount of the court's time and we are confident that an understanding of the facts will be of such great assistance in determining the questions involved that on the whole the labors of the court will be lightened if it orders the entire record sent up.

II.

An additional important question not certified arises in the case.

The other questions in the case are (1), whether the offer was so framed as to be applicable to the petitioners and their contracts and therefore whether any offer was really made to these petitioners; (2), whether the offer, if made to the petitioners, and, even if fair as to creditors generally, was fair and adequate as to these petitioners and their contracts.

The first of these questions, of course, relates to the form of the offer and therefore is perhaps not of sufficient public importance to call for an exercise of this court's extraordinary powers. The second question, however, is of great public importance, and ought to be

determined, since the validity of many future railroad re-organizations may depend upon the answer. Our position is that an offer to settle on the basis of an attempted liquidation of damages under a 200-year operating contract or railroad lease, the damages for breach of which are not susceptible of accurate ascertainment, is not a fair and equitable offer to the obligee of such a contract, however fair it may be as to ordinary commercial creditors.

It has been frequently held that terminal and trackage contracts are specifically enforcible in equity, either at the instance of the lessor or of the lessee (using the terms "lessor" and "lessee" in a non-technical sense). See *Pennsylvania Railroad Company* v. *St. Louis-Alton Railroad Company*, 118 U. S. 290; *Grand Trunk Railway Company* v. *Chicago Railroad Company*, 141 Fed. 785; *Prospect Park Railroad Company* v. *Coney Island Railroad Company*, 144 N. Y. 152; *Schmidt* v. *Railway Company*, 101 Ky. 441, 41 S. W. 1015; *Southern Railway Company* v. *Franklin Railway Company*, 96 Va. 698, 32 S. E. 485; *Joy* v. *St. Louis*, 138 U. S. 1; *Chicago Railway Company* v. *Denver Railroad Company*, 143 U. S. 596; *Telegraph Company* v. *Harrison*, 145 U. S. 459; *Union Pacific Railway Company* v. *Railway Company*, 163 U. S. 564; *Central Trust Company* v. *Wabash Railway Company*, 29 Fed. 546; *Union Pacific Railway Company* v. *Railway Company*, 128 Fed. 230; *South Railroad Company* v. *Highland Railroad Company*, 117 Ala. 395, 23 Southern, 973; *Louisville Railway Company* v. *Railway Company*, 92 Tenn. 681, 22

S. W. 920; *Great Northern Railway Company* v. *Manchester Railway Company*, 5 DeGex & Smale, 138; *Wolverhampton Railway Company* v. *London Railway Company*, L. R. 16 Eq. 433.

These cases are based on the impossibility of adequately measuring the damages and also on the public interest involved. It is plain that, if a corporation bound by such a contract undertook to relieve itself of liability by conveying all of its property to another corporation composed of the same stockholders, its attempt would be unsuccessful. It is equally plain that it could not, by such conveyance, relegate the obligee of the contract to an action at law against the new corporation. Where, as here, there is a stockholders' re-organization which "instead of being effectuated by a private sale is consummated by a Masters' deed under a consent decree," the situation is precisely the same, with the single qualification that the new company may relieve itself of liability by making a fair offer to the obligee of the contract.

But the offer must be fair *as to the obligee of the contract*. It is not enough that it is fair as to other people. (*Pierce* v. *United States*, 255 U. S. 398, 403; *Howard* v. *Maxwell Motor Co.*, 269 Fed. 292, 304, 306, 275 Fed. 53.) To be fair to the obligee of such a contract as we have here, it must be an offer which gives the obligee some certain and definite benefit which has priority over the benefits received by the stockholders. An offer which requires the conversion of all rights under such a contract into money damages does not meet

this requirement. Any attempt to liquidate the damages payable by reason of the violation of the contracts here involved will result in the determination of a sum which may prove to be grossly erroneous in the light of subsequent events during the continuance of the contracts. The rights of the appellants under the contracts are not susceptible of liquidation except by a process of inferences which is bound to produce inequitable results. If an attempt were made to liquidate the claim of the Terminal Company, the claim would take the shape of the right to compensation for certain facilities and certain service furnished by the Terminal Company. The extent of the facilities to be furnished and of the service to be rendered, and, consequently, the compensation payable therefor, cannot be determined at the present time. The extent of the use of the property by the MKT Company may increase several hundred per cent or it may diminish. The compensation payable will likewise be increased or diminished. The number of companies using the Terminal Company's facilities may increase or diminish, in which event the compensation payable by the MKT Company would decrease or increase. It is thus difficult, if not impossible, to liquidate the claim in any such way as to fairly compensate the petitioners, even if the full amount so determined were payable in cash.

An offer of preferred stock or income bonds to creditors whose claims are susceptible of measurement or liquidation, if adequate, is, of course, fair and equitable, but an offer of stock or income bonds to obligees

of contracts whose claims are not susceptible of measurement or ascertainment is clearly inappropriate and, therefore, not fair and equitable.

To state the proposition in another form. The re-organization managers, with the consent and approval of the court, gave to the stockholders of the old company a certain part of the value of the property of the Missouri, Kansas & Texas Company which in equity belongs to the creditors and to the obligees of the contracts. The property, therefore, to which the appellants, as obligees of the contracts, have a right to look for the satisfaction of their rights against the Missouri, Kansas & Texas Company (and to which the stockholders have no right as against them), is taken *by a court of equity* from the parties so entitled to it and given to the parties which have no right to it. This obligates the court to give to the appellants at least their share of the property thus diverted. The doctrine requiring fair offers to creditors is only a *means* devised by equity to restore to the creditors and the obligees of the contracts what the court itself has thus by its own action diverted from them.

In the case of ordinary creditors, whose claims are subject to liquidation, an offer to settle on the basis of the liquidation of the claims is doubtless an appropriate means, but the nature of the offer required must vary with the character of the situation, and, where the only offer is of a form inappropriate to restore to the obligees of the contracts the equity taken from them and given to the stockholders, then the justification for the offer

does not exist and the situation is precisely the same as if the corporation had voluntarily transferred its assets to a new corporation organized among its own stockholders for the purpose of receiving them. (*Pierce* v. *United States,* 255 U. S. 398.)

That the service contemplated by these contracts is desirable and even essential to the new company and to the public is thus stated by the Circuit Court of Appeals in the former case:

> "The use of these Terminal facilities is so patently for the benefit both of the public and of all railroads entering Kansas City, that it is difficult to conceive that any such railroad would ever actually cease to use such facilities" (294 Fed. l. c. 39.)

That the interest of the public is the paramount consideration in a court of equity in matters affecting railroads, is shown by the cases of *Joy* v. *St. Louis,* 138 U. S. L., and *Chicago, Rock Island & Pacific Railway* v. *Union Pacific Railway Company,* 47 Fed. 15.

The interest of the public being paramount and it being apparently conceded by both the new company and by the Circuit Court of Appeals that that interest requires the use of these facilities by the new company, it follows that a court of equity, in determining what is a fair offer to the obligees of the contracts covering the use of these facilities, must take that public interest into consideration. The public interest is wholly ignored by an offer which contemplates an attempted liquidation of the contracts and (so far as the court is concerned) a complete abandonment of the facilities. No offer could

give due regard to the public interest unless it provided for the continuance of the use of these facilities (whose use is conceded to be of paramount public importance).

The object of the offer being to work substantial justice, is it not fairly clear that to attain its object the offer to obligees of contracts such as here involved must tender alternative benefits: (1) the performance of the main objects of the contracts either upon the terms provided in the contracts or (if there is anything inequitable in the contracts in the opinion of the court) upon just and equitable terms to be approved by the court, or, at the option of the offeree, (2) ascertainment of the damages for breach of the contracts and participation in the securities of the purchasing corporation upon the same terms as commercial creditors?

We have said enough to illustrate the character and importance of the question. A more elaborate argument is not appropriate here.

It may be that the court will desire to hear the arguments on the questions certified before determining whether the entire record should be sent up, as was done in *Northern Pacific Railway Company* v. *Walker*, 148 U. S. 391; *Shaw* v. *Kellogg*, 170 U. S. 312; *Sigafus* v. *Porter*, 179 U. S. 116; *Brunswick Co.* v. *National Bank*, 192 U. S. 386, and we have no objection to that course; but from our knowledge of the case we feel

certain the court will, at some time, conclude that a decision of the whole case is desirable, and we, therefore, respectfully submit that this petition should be granted.

EDWARD J. WHITE,
N. H. LOOMIS,
BRUCE SCOTT,
GARDINER LATHROP,
SAMUEL W. SAWYER,
Counsel for Petitioners.

H. H. FIELD,
W. F. DICKINSON,
N. S. BROWN,
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Office Supreme Court, U. S.
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No. 265.

Supreme Court of the United States

OCTOBER TERM, 1925.

KANSAS CITY TERMINAL RAILWAY COMPANY, ET AL.,

VS.

CENTRAL UNION TRUST COMPANY OF NEW YORK, ET AL.

ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

BRIEF OF KANSAS CITY TERMINAL RAILWAY COMPANY, ET AL.

EDWARD J. WHITE,
N. H. LOOMIS,
BRUCE SCOTT,
GARDINER LATHROP,
SAMUEL W. SAWYER,
Counsel for Kansas City Terminal Railway Company, et al.

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ON CERTIFICATE FROM THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE EIGHTH CIRCUIT.

OPINIONS IN THE COURTS BELOW.

There is no reported opinion of either of the courts below. An opinion of the United States Circuit Court of Appeals for the Eighth Circuit on a former appeal involving a different question is reported as *Kansas City Terminal Railway Company et al.* v. *Central Union Trust Company of New York et al.*, 294 Federal 32.

GROUNDS OF JURISDICTION.

The ground of jurisdiction is a certificate of questions or propositions of law certified to this Court by the United States Circuit Court of Appeals for the Eighth Circuit, in accordance with Section 239 of the Judicial Code and Rule 37 of the Rules of this Court promulgated December 22, 1911 (now Rule 34). The original certificate was filed in this Court on February 2, 1925, but it was afterwards amended by the Circuit Court of Appeals, and the amended certificate was filed in this Court on April 25, 1925. The statutory provision under which jurisdiction is invoked is Section 239 of the Judicial Code. The following cases are believed to sustain the jurisdiction of this Court:

Lau Ow Bew, Petitioner, 141 U. S. 583, 144 U. S. 47, 58.

Hertz v. *Woodman*, 218 U. S. 205.

Stratton's Independence v. *Howbert*, 231 U. S. 399.

United States v. *Mayer*, 235 U. S. 55.

STATEMENT OF THE CASE.

The questions certified by the Circuit Court of Appeals are intended to present for this Court's determination what kind of offer to general creditors (in its relation to the provision made for stockholders of the old company in a railroad reorganization plan) is necessary in order to comply with the rule laid down by this Court in *Northern Pacific Railway Company* v. *Boyd*, 228 U. S. 482 (hereafter called the "Boyd case").

The questions certified are as follows:

> QUESTION I. Is a plan of reorganization of a railway company sufficient as to unsecured creditors and binding upon them which does not give precedence to the entire claim of the creditor over any part or interest of a stockholder in the old company?
>
> QUESTION II. Is such a plan fair and binding upon such creditors even though they be offered securities of the same grade as the stockholders, the difference being only in the greater amount offered the creditors, provided the court shall be of the opinion that the offer tenders to such creditors all that could reasonably be expected under all of the existing circumstances?
>
> QUESTION III. Is such offer as to such creditors fair and binding if it consists only of the same grade of securities as offered the stockholders, the difference being that the right of the stockholders to participate is conditioned upon the payment of an assessment or the payment of a relatively greater assessment than that asked of such creditors, provided the court shall be of the opinion that the offer tenders to such creditor all that could reasonably be expected under all of the existing circumstances? (Certificate, p. 3.)

The nature of the cause and the facts on which the questions of law arise are set out in the amended certificate, as required by the rules of this Court. Those deemed immediately pertinent will be here stated. Opposing counsel will doubtless refer to others which they deem pertinent.

In a receivership and foreclosure suit involving the Missouri, Kansas & Texas Railway Company, these appellants filed an intervention in which they asserted priority over the M. K. & T. mortgages for certain contracts to which they were parties. Priority was denied by the District Court and its order in that respect affirmed by the United States Circuit Court of Appeals for the Eighth Circuit (*Kansas City Terminal Railway Company et al.* v. *Central Union Trust Company of New York et al.*, 294 Fed. 32). A foreclosure sale followed, at which the property was purchased for the benefit of a reorganized company formed under a re-organization plan. As stated in the certificate: "The purchase was in pursuance of a reorganization plan." The stockholders of the old company were participants in the plan. The plan provided (1) that holders of preferred stock of the old company should receive $14 in Prior Lien Bonds (bearing six per cent interest), $6 in Cumulative Adjustment Mortgage Bonds (which were income bonds secured by mortgage as to principal), and one share of common stock in the new company, upon payment of $20 for each share of stock of the par value of $100 held in the old company, and (2) that holders of the common stock of the old company should receive $17.50 in Prior Lien Six Per Cent Bonds, $7.50 in

Adjustment Bonds and one share of common stock, upon payment of $25 for each share of stock of the par value of $100 held in the old company (Certificate, p. 2).

It will thus be seen that the stockholders of the old company received share for share in stock, but upon condition that they should take and pay for at par a certain amount of bonds—at the rate of $20 for each share of preferred stock in the old company and $25 for each share of common stock.

The offer made to unsecured creditors was in the alternative, and we will refer to the alternatives as Offer A and Offer B.

Offer A tendered one-third of a share of preferred stock of the par value of $100 and two-thirds of a share of common stock for each $100 of the aggregate amount of the claim (including interest to January 1st, 1922) (Certificate, p. 2).

Offer B tendered $14 in Prior Lien Mortgage Six Per Cent Bonds and $6 in Adjustment Bonds and one share of common stock upon payment of $18 for each $100 of claim (Certificate, p. 3).

It will be noted that Offer A gives the unsecured creditor a preference as to one-third of his claim, but not as to two-thirds of it, and that Offer B is precisely the same as the offer made to holders of preferred stock, except that the amount the creditor is required to pay for his bonds is $2 less for each $100 of claim.

Kansas City Terminal Railway Company *et al.*, appellants below, contended in the District Court and also in the Circuit Court of Appeals that neither Offer

A nor Offer B "preserved" the creditor's "interest" and therefore, that neither was "a fair offer" within the Boyd case (228 U. S. l. c. 508). The Circuit Court of Appeals, by its certificate, in effect, requests that this court make more specific the application of its decision in the Boyd case.

After the certificate was filed in this Court, the appellants below filed a motion in this Court to send up the entire record under Rule 37 of the Rules of this Court of December 22, 1911 (now Rule 34). This motion has not been determined by the Court and is still pending. The reasons for the motion are fully set out in the brief attached to the motion, and we deem it inappropriate to discuss them here, as this brief, under the rules of this Court, must be confined to the propositions of law certified.

SUMMARY OF THE ARGUMENT.

The ultimate question to be decided (upon which the answers to the questions propounded by the Circuit Court of Appeals depend) is whether the general creditor is entitled to retain in the new corporation his priority over the old stockholder, or whether he must be content with what the chancellor may find to be "fair" treatment; whether his rights and status are to be determined according to a definite principle, or according to the personal conceptions of individual judges.

The Boyd case recognizes the practical necessity of permitting stockholders to participate in a railroad re-organization, provided the unsecured creditors are also permitted to participate, and provided the priority of creditors over stockholders is not impaired. The Court says that the creditor's interest "can be preserved by the issuance on equitable terms of income bonds or preferred stock" (l. c. 508).

While the Court does not say that the method suggested is the only method, it is implied that either the method suggested or some substantial equivalent is essential.

This Court, moreover, in the case of *Louisville Trust Company* v. *Louisville, etc. Railway Company*, 174 U. S. 674, which preceded the Boyd case, plainly indicated that, if any interest of the mortgagor is preserved after foreclosure, the "prior rights" of general creditors must necessarily be secured and preserved and "any arrangement of the parties by which the *sub-*

ordinate rights and interests of the stockholders are attempted to be secured at the expense of the *prior rights* of either class of creditors comes within judicial denunciation" (l. c. 683).

The suggestion of the Court in the Boyd case that general creditors need not be paid in cash is really a relaxation of the general principle of equity that the property of a corporation in the hands of a voluntary transferee or of the mortgagor purchasing at its own sale is still subject to all claims existing against it before the transfer. This indulgence to the re-organizer grows out of the practical impossibility of selling railroad properties for cash, the public interest in their successful financing and operation and the practical need of securing co-operation, instead of conflict, between the bondholder and the stockholder. It is analogous to the judicial rules regarding preferential claims for operating expenses and the issuance of receiver's certificates to insure continued operation of railroads. Like them, it must not be extended beyond the reason for its existence nor be allowed to degenerate into a mere phrase to be applied according to the individual whim of the Chancellor. The Boyd case emphatically declared that the question whether *any* provision must be made for the creditor must be determined by a "fixed principle." Equally, the question *what* provision must be made for the creditor must be determined by a fixed principle. The only fixed principle which is consonant with the spirit of the Boyd case is suggested by the language of the Boyd case—the issuance of securities to the general creditor which will preserve the normal

relation between him and the stockholder of the old company. It is difficult, if not impossible, to formulate any other fixed principle which is not purely arbitrary.

This principle has the advantage of enabling reorganization managers to know what they can do and creditors to know what their rights are.

It is thoroughly practical. It was successfully applied as early as 1882 in the Toledo, Peoria and Warsaw reorganization (9 Fed. 738) and has aided two of the largest and most successful railroad reorganizations of recent years—the Missouri Pacific (280 Fed. 38) and the Rock Island (284 Fed. 945).

The only offers to creditors which have been upheld by any of the Circuit Courts of Appeals since the Boyd case upon direct attack are the offers in the Missouri Pacific case and the Rock Island case, both of which gave the creditor preferred stock to the full amount of his claim.

These conclusions require negative answers to the questions certified.

ARGUMENT.

Nature of the Questions.

In order to meet the questions propounded by the Circuit Court of Appeals, it is necessary to know what the Boyd case settled and what it left open.

All will agree that it settled the proposition that, if the stockholder participates in a railroad re-organization, *some* provision must be made for the general creditor.

Opposing counsel will contend that it left open the question *what* provision must be made for the creditor.

Our position is that the decision, when read in the light of its judicial history and of the reasons which prompted it, settled this question, too, for all practical purposes; that is to say, the logical conclusion to be drawn from the decision is that the general creditor must be offered some form of participation which will maintain the normal relation between creditor and stockholder and preserve to the creditor his priority in rank over the old stockholder.

Our argument will be better understood if preceded by a brief sketch of the decisions of this Court and of the lower Federal Courts both before and after the decision of the Boyd case.

The Boyd Case and Later Cases.

The Boyd case was decided on April 28, 1913. This Court held that an unsecured creditor of a railroad company could, in equity, subject to his claim the prop-

erty of a railroad company in the hands of a re-organized company which purchased at foreclosure sale, because the stockholders of the old company participated in the re-organization by exchanging their stock for stock in the re-organized company, and no provision was made, either by the plan of re-organization or in pursuance of it, for participation by the unsecured creditors. The basis of the stockholders' participation was (1) one-half share of new preferred stock and one-half share of new common stock for each share of old preferred stock—upon payment of $10 for each old share held, and (2) one share of new common stock for each share of old common stock, upon payment of $15 per share. No bonds or other preferred securities were received by the stockholders in return for these assessments.

By way of dictum, the Court said that, in a railroad reorganization, the general creditors need not be paid in cash, but that their interests could be "preserved by the issuance on equitable terms of income bonds or preferred stock."

The Court's theory is best stated in the Court's own language:

> * * * "The case, though presenting various aspects, is controlled by a single proposition. For although Boyd was not a party to the foreclosure, and was not made such by the publication notifying creditors to prove their claims, yet the original and supplemental decrees were *free from any moral or actual fraud* and were, in form and nature, sufficient to have passed a title good against him, unless the contract of reorganization, reserving a stock interest in the new company for the old share-

holders, left the property still subject to the claims of non-assenting creditors of the Northern Pacific Railroad (l. c. 501, 502).

"Corporations, insolvent or financially embarrassed, often find it necessary to scale their debts and readjust stock issues with an agreement to conduct the same business with the same property under a reorganization. This may be done in pursuance of a private contract between bondholders and stockholders. And though the corporate property is thereby transferred to a new company, having the same shareholders, the transaction would be binding between the parties. *But, of course, such a transfer by stockholders from themselves to themselves cannot defeat the claim of a non-assenting creditor.* As against him the sale is void in equity, regardless of the motive with which it was made. For if such contract re-organization was consummated in good faith and in ignorance of the existence of the creditor, yet when he appeared and established his debt the subordinate interest of the old stockholders would still be subject to his claim in the hands of the reorganized company. *Cf. San Francisco & N. P. R. R.* v. *Bee*, 48 California 398; *Grenell* v. *Detroit Gas Co.*, 112 Michigan 70. *There is no difference in principle if the contract of reorganization, instead of being effectuated by private sale, is consummated by a master's deed under a consent decree* (l. c. 502).

"It is argued that this is true only where there is fraud in the decree—the appellants insisting that in all other cases a judicial sale operates to pass a title which cuts off all claims of unsecured creditors against the property."

(Here follow citation and discussion of cases cited.)

* * * "This makes the creditor's legal right against the shareholders' interest depend upon the motive with which they act and the method by which they carry out the scheme. * * *

"Such and similar possibilities at one time caused doubts to be expressed as to whether a court could permit a foreclosure sale which left any interest to the stockholders. But it is now settled that such reorganizations are not necessarily illegal, and, as proceedings to subject the property must usually be in a court where those who ask equity must do equity, such reorganizations may even have an effect more extensive than those made without judicial sale, and bind creditors who do not accept fair terms offered. The enormous value of corporate property often makes it impossible for one, or a score, or a hundred bondholders to purchase, and equally so far for stockholders to protect their interests. A combination is necessary to secure a bidder and to prevent a sacrifice. Co-operation being essential, there is no reason why the stockholders should not unite with the bondholders to buy in the property" (l. c. 502, 503, 504).

"* * * For, if purposely or unintentionally a single creditor was not paid, or provided for in the reorganization, he could assert his superior rights against the subordinate interests of the old stockholders in the property transferred to the new company. *They were in the position of insolvent debtors who could not reserve an interest as against creditors.* Their original contribution to the capital stock was subject to the payment of debts. The property was a trust fund charged primarily with the payment of corporate liabilities. Any device, whether by private contract or judicial sale under consent decree, whereby stockholders were preferred before the creditor was invalid. *Being bound for the debts, the purchase of their property, by their new company, for their benefit, put the stockholders in the position of a mortgagor buying at his own sale* (l. c. 504, 505).

* * * "*As between the parties and the public generally, the sale was valid. As against creditors, it was a mere form.* Though the Northern Pacific Railroad was divested of the legal title, *the*

old stockholders were still owners of the same railroad, encumbered by the same debts. The circumlocution did not better their title against Boyd as a non-assisting creditor. They had changed the name but not the relation. The property in the hands of the former owners, under a new charter, was as much subject to any existing liability as that of a defendant who buys his own property at a tax sale (l. c. 506, 507).

"The invalidity of the sale flowed from the character of the reorganization agreement regardless of the value of the property, for in cases like this, *the question must be decided according to a fixed principle*, not leaving the rights of the creditors to depend upon the balancing of evidence as to whether, on the day of sale the property was insufficient to pay prior encumbrances (l. c. 507).

* * * "*This conclusion does not*, as claimed, require the impossible and *make it necessary to pay an unsecured creditor in cash* as a condition of stockholders retaining an interest in the reorganized company. *His interest can be preserved by the issuance, on equitable terms, of income bonds or preferred stock.* If he declines a fair offer he is left to protect himself as any other creditor of a judgment debtor, and, having refused to come into a just reorganization, could not thereafter be heard in a court of equity to attack it. If, however, no such tender was made and kept good he retains the right to subject the interest of the old stockholders in the property to the payment of his debt" (l. c. 508).

(Italics in this and subsequent quotations are ours.)

It will be noted that the Court treats a re-organized company in which the stockholders of the old company participate, and the creditors do not, as in precisely the situation of a new company organized by the same stockholders and receiving a voluntary transfer of the prop-

erty (l. c. 502) or a mortgagor buying at its own sale (l. c. 504) or an owner buying in its own property at a tax sale (l. c. 507).

The Boyd case has been followed by *The Kansas City Southern Railway Company* v. *Guardian Trust Company*, 240 U. S. 166, (decided February 21, 1916), and *Pierce* v. *United States*, 255 U. S. 398, (decided March 7, 1921).

In the Kansas City Southern case, the attention of this Court was chiefly occupied with questions affecting the right of the Guardian Trust Company to take advantage of the doctrine of the Boyd case. The doctrine itself was referred to as the "well settled rule of equity" (l. c. 178). The dissents in the case were based upon the finding of the master that there was no liability, to which the Guardian Trust Company had not excepted (See *Central Improvement Company* v. *Cambria Steel Company*, 210 Fed. l. c. 699).

In the Pierce case, this Court affirmed a decree which satisfied a judgment against the Waters-Pierce Oil Company out of the proceeds of the sale of the property of that company in the hands of its stockholders. The Court relied upon the Boyd case and the Kansas City Southern case and treated the situation of stockholders receiving the proceeds of the sale in cash as parallel to that of stockholders participating in a reorganization upon foreclosure. The Court said:

> "* * * The law which sends a corporation into the world with the capacity to act imposes upon its assets liability for its acts. The corporation cannot disable itself from responding by distribut-

ing its property among its stockholders and leaving remediless those having valid claims" (l. c. 402).

The decision in the Boyd case was forecast by the decisions of this Court in *Chicago, Rock Island & Pacific Railroad Company* v. *Howard,* 7 Wall. 392, (decided February 8, 1869) hereafter called the "Howard case," and *Louisville Trust Company* v. *Louisville, etc. Railroad Company,* 174 U. S. 674, (decided May 22, 1899), hereafter called the "Monon case."

The Howard Case.

In the Howard case, the bondholders and the stockholders, by agreement between themselves, arranged for a sale of the property of the Mississippi & Missouri Railroad Company to Chicago, Rock Island & Pacific Railroad Company and for the distribution of the proceeds of the sale among themselves in agreed proportions—the bondholders to receive 84 per cent of the purchase price and the stockholders, 16 per cent. It was agreed between them and the purchaser, that they would cause foreclosure of the mortgage, purchase at the sale by trustees, and transfer by the trustees to a new company to be organized by the purchaser. No provision was made for unsecured creditors. The Court affirmed a decree which subjected the stockholders' share of the proceeds of the sale to the claim of an unsecured creditor. The Court said:

"Equity regards the property of a corporation as held in trust for the payment of the debts of the corporation, and recognizes the right of creditors to pursue it into whosesoever possession it may

be transferred, unless it has passed into the hands of a bona fide purchaser; and the rule is well settled that stockholders are not entitled to any share of the capital stock nor to any dividend of the profits until all the debts of the corporation are paid.

* * * * * * *

"Valid contracts made by a corporation survive even its dissolution by voluntary surrender or sale of its corporate franchises, and the creditors of the corporation, notwithstanding such surrender or sale, may still enforce their claims against the property of the corporation as if no such surrender or sale had taken place. Moneys derived from the sale and transfer of the franchises and capital stock of an incorporated company are assets of the corporation, and as such constitute a fund for the payment of its debts, and if held by the corporation itself and so invested as to be subject to legal process, the fund may be levied on by such process; but, if the fund has been distributed among *the stockholders, or passed into the hands of other than bona fide creditors or purchasers, leaving any debts of the corporation unpaid, the established rule in equity is, that such holders take the fund charged with the trust in favor of creditors,* which a court of equity will enforce, and compel the application of the same to the satisfaction of their debts.

"Regarded as the trustee of the corporate fund, the corporation is bound to administer the same in good faith for the benefit of creditors and stockholders, and all others interested in its pecuniary affairs, and any one receiving any portion of the fund by voluntary transfer, or without consideration, may be compelled to account to those for whose use the fund is held. *Creditors are preferred to stockholders on account of the pecuniary trust in their favor, and because the latter as constituent members of the corporate body, are regarded as sustaining, in that aspect, the same relation to the former as that sustained by the corporation*" (l. c. 409).

Between the decision of the Howard case and the decision of the Monon case, this Court had occasion to consider some phases of railroad foreclosures and reorganizations, and they are thus referred to in *Canada Southern Railway Company* v. *Gebhard*, 109 U. S. 527:

> "It rarely happens in the United States that foreclosures of railway mortgages are anything else than the machinery by which arrangements between the creditors and other parties in interest are carried into effect, and a reorganization of the affairs of the corporation under a new name brought about" (l. c. 539).

The Monon Case.

In the Monon case, the Court held that an unsecured creditor, on intervention, had a right to be heard upon his allegations that a railroad foreclosure and re-organization had been instituted and were being conducted for the purpose of preventing the collection of any unsecured debts and of keeping in the stockholders an interest in the new company to the exclusion of the creditors, and reversed a decree of the lower court which had dismissed the intervention without hearing evidence. This Court said:

> "We refer to these matters not for the sake of reviewing those decisions, but to note the fact that foreclosure proceedings of mortgages covering extensive railroad properties are not necessarily conducted with the limitations that attend the foreclosures of ordinary real estate mortgages.
>
> "We notice, again, that railroad mortgages, or trust deeds are ordinarily so large in amount that on foreclosure thereof only the mortgagees, or their representatives, can be considered as probable purchasers. While exceptional cases may occur, yet

this is the rule, as shown by the actual facts of foreclosure proceedings, as well as one which might be expected from the value of the property and the amount of the mortgage (l. c. 682).

* * * * * * *

"Assuming that foreclosure proceedings may be carried on to some extent at least in the interests and for the benefit of both mortgagee and mortgagor, (that is, bondholder and stockholder), we observe that no such proceedings can be rightfully carried to consummation which recognize and preserve any interest in the stockholders without also recognizing and preserving the interests, not merely of the mortgagee, but of every creditor of the corporation. In other words, if the bondholder wishes to foreclose and exclude inferior lienholders or general unsecured creditors and stockholders he may do so, but *a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and preserve the prior rights of general creditors thereof.* This is based upon the familiar rule that the stockholder's interest in the property is subordinate to the rights of creditors; first of secured and then of unsecured creditors. And any arrangement of the parties by which the subordinate rights and interests of the stockholders are attempted to be secured at the expense of the prior rights of either class of creditors comes within judicial denunciation" (l. c. 683, 684).

"* * * Can it be that when in a court of law the right of an unsecured creditor is judicially determined, and that judicial determination carries with it a right superior to that of the mortgagor, the mortgagor and mortgagee can enter into an agreement by which through the form of equitable proceedings all the right of this unsecured creditor may be wiped out, and the interest of both mortgagor and mortgagee in the property preserved and continued? The question carries its own answer. Nothing of the kind can be tolerated" (l. c. 684).

"We may observe that a court, assuming in foreclosure proceedings the charge of railroad property by a receiver, can never rightfully become the mere silent registrar of the agreements of mortgagee and mortgagor" (l. c. 688).

Decisions in the lower federal courts after the Howard case and the Monon case.

Following the decision of this Court in the Howard case, there was comparatively little consideration of its effect in the decisions of the Federal Courts. Apparently, both counsel and the courts overlooked its prophetic character. Doubtless, a number of re-organizations were consummated, which today would be open to attack under the Boyd case.

The few cases which do discuss the Howard case show no unanimity in their conception of it.

The earliest case which we have found is *Hancock* v. *Toledo, etc., Railroad Company,* 11 Biss. 148, 9 Fed. 738, decided by Blodgett, J., in the Northern District of Illinois on January 4, 1882. It was there sought to subject to the claim of an unsecured creditor the common stock of a new company purchasing at a foreclosure sale under a re-organization plan. The framers of the re-organization plan evidently had a thorough comprehension of the potential effect of the Howard case, because the plan is one which would be sustained today as against unsecured creditors under the Boyd case. The re-organization plan called for a first mortgage and a second mortgage—the latter securing both first preferred income bonds and second preferred income bonds. The unsecured creditors of the old company were to receive second preferred income bonds to the entire amount of their indebtedness *and interest.*

The holders of the first preferred stock of the old company were to receive common stock of the new company to the amount of 50 per cent of their former holdings. The holders of old second preferred stock were to receive new common stock to the amount of 30 per cent of their former holdings, and the holders of old common stock were to receive new common stock to the amount of 25 per cent of their former holdings—the stock of the new company being all common stock. The court held that sufficient provision was made for the creditors within the rule of the Howard case, saying:

> "It will be seen that while the Mississippi & Missouri Railroad Company was largely indebted to certain unsecured creditors, no provision was made under the scheme of re-organization for any payment or security to the unsecured creditors. * * *
>
> "Here, however, express provision is made for the holders of all the floating debt by giving them, in lieu of and substitution for their evidences of debt against the old company, second preferred income bonds of the new company equal to the amount of such floating debt and interest. This income bond is, by the terms of agreement, a higher grade of security than the stock of the old company; that is, the stockholders get no dividend until the interest on these bonds is all paid. The stockholders are placed behind the holders of these bonds, and the plan seems to fairly contemplate the protection of all classes of creditors of the old company *in the equitable order of their priority.* It was the evident purpose of the parties to this agreement to *place these floating-debt holders in at least as good a relation to the new company as they bore to the old company*" (l. c. 741, 742).

On the other hand, in *Paton* v. *Northern Pacific Railway Company*, 85 Fed. 838 (decided July 22, 1896),

a distinguished jurist, Judge Jenkins, held sufficient as to unsecured creditors the very re-organization plan condemned in the Boyd case. He held that it must be determined from the facts of each particular case whether the unsecured creditor could complain of being eliminated, saying:

> "It is no doubt true, as ruled in *Railroad Co.* v. *Howard*, 7 Wall. 392, that the disposition of the property of a corporation among its stockholders without providing for the payment of the debts of the corporation is a fraud upon creditors. It, however, is essential to look at the facts of each case in order to accurately apply the principle enunciated; for if the contention of counsel for complainant be correct, all agreements of re-organization of bankrupt corporations which fail to give all creditors of the corporation an interest in the re-organization, or which fail to satisfy the debts of the corporation, and which accord to stockholders of the old corporation upon any terms an interest in the new corporation, are prohibited by the law, and void. If such conclusion result from the decision in the Howard Case, the result must prove disastrous, uprooting past re-organizations of great magnitude, and seriously crippling, if not preventing, any future re-organization of bankrupt corporations" (l. c. 840).

In *Central of Georgia Railway Company* v. *Paul*, 93 Fed. 878, (C. C. A. 5th Circuit, decided April 18, 1899), the court affirmed a decree enforcing the claim of an unsecured creditor, for whom no provision had been made in a re-organization plan. The plan gave the minority stockholders of the old company income bonds for the full amount of their stock (l. c. 882) and the majority stockholders $5,000,000 par value of stock in the new company for $4,200,000 par value of stock in the

old company (l. c. 882). The court relied on the Howard case.

See also *Farmers' Loan & Trust Company* v. *Missouri I. & N. Railway Company*, 21 Fed. 264, 267 (Circuit Court, S. D. Iowa, 1884).

Chattanooga R. & C. Railroad Company v. *Evans*, 66 Fed. 809, 822 (C. C. A. 6th Circuit, 1895).

Even the decision in the Monon case apparently did not prepare all of the bar nor all of the lower Federal Courts for the decision in the Boyd case. In fact, some of the language in the Monon case lent color to the view that actual fraud was a necessary element, and this theory was, in some instances, eagerly applied without any real effort to analyze the underlying principles governing the Howard case and the Monon case.

In the first reported opinion considering the Monon case, however, a clear conception of the case is exhibited (*St. Louis Trust Company* v. *Des Moines, etc., Railway Company*, 101 Fed. 632, decided May 18, 1900). Judge Shiras of the Southern District of Iowa, there held that the assets purchased at foreclosure sale by a re-organized company should be subjected to the claim of an unsecured creditor of the old company, where no offer had been made to the unsecured creditors and where the stockholders of the old company exchanged their stock for stock in the new company.

At about the same time, Circuit Judge Woods, who had been in charge of the receivership and foreclosure involved in the Monon case, and to whose lot fell the

creditor was excluded and the stockholder included. It made it equally clear that the creditor's rights must be determined according to a fixed principle (l. c. 507) and not upon some hazy determination by the chancellor as to whether the creditor had been "unfairly eliminated" or there was "actual fraud."

Since, however, no offer at all had been made to the creditor in the Boyd case, it was not necessary for the Court to define in precise terms what was requisite for a sufficient offer. Consequently, we find the same tendency on the part of re-organization managers and some of the Federal Courts to whittle away the creditors' rights, which occurred following the decisions in the Howard case and the Monon case. On the other hand, we find some re-organization plans and some of the decisions of the Federal Courts (including all of the decisions of the Circuit Courts of Appeals, so far as they directly involve the question) giving full recognition to the spirit and evident intent of this Court's decision in the Boyd case. Pertinent decisions in the state courts are rare.

(a) Decisions in the Circuit Courts of Appeals.

Keech v. *Stowe-Fuller Company,* 205 Fed. 887, (C. C. A. 6th Circuit, decided June 3, 1913). The re-organization plan provided that holders of both preferred and common stock should have the right to subscribe for bonds to the amount of ten per cent of their holdings and to receive in exchange for their stock—the holders of preferred stock, 100 per cent in common stock of the new company, and the holders of common stock, 50 per

cent in common stock of the new company. The creditors were give 50 per cent in cash. *The court did not pass upon the re-organization plan, as its fairness was not before the court.* The only question before the court was whether a particular intervener was entitled to the benefit of the plan, and the court held that it was. The corporation re-organized was not a railroad company.

Western Union Company v. *United States & Mexican Trust Company,* 221 Fed. 545, (C. C. A. 8th Circuit, decided March 16, 1915). The Company involved was the Kansas City, Mexico and Orient Railway Company. The re-organization plan apparently made no provision for creditors. The exact nature of the provision made for stockholders does not appear in the opinion. The court did not pass on the fairness of the plan, but held that the lower court committed error in refusing to permit an intervening creditor to raise the question of its fairness by his intervention. The discussion of principles went only so far as was necessary to decide the point before the court. The language of the court was not intended to be and ought not to be construed as an accurate statement of the limits of those principles.

Howard v. *Maxwell Motor Company,* 269 Fed. 292, affirmed 275 Fed. 53 (C. C. A. 2nd Circuit, decided June 1, 1921). A re-organization plan provided that the creditors of subsidiary companies should be paid in full in cash, that the creditors of the parent company should receive for each $100 of indebtedness:

Cash,	$25.00
First Preferred Stock in New Company,	25.00
Second Preferred Stock,	25.00
Common Stock,	15.00
	$90.00

And that the holders of preferred stock of the parent company should receive upon payment of $24 for each share of stock in the old company:

New First Preferred Stock,	$24.00
New Second Preferred Stock,	25.00
New Common Stock,	30.00
	$79.00
Less "Assessment,"	24.00
	$55.00

And that the holders of common stock of the parent company should receive upon payment of $24 per share of stock:

First preferred Stock,	$24.00
Second Preferred Stock,	17.50
Common Stock,	30.00
	$71.50
Less "Assessment,"	24.00
	$47.50

Here again, *the fairness of the plan was not considered*, but it was held that the holder of a contingent claim, for whom no provision was made in the plan, was entitled to enforce his claim against the assets of the

old company in the hands of the new company. The corporation re-organized was not a railroad company.

Walsh Tie & Timber Company v. *Missouri Pacific Railway Company*, 280 Fed. 38 (C. C. A. Eighth Circuit, decided March 29, 1922). The fairness of the offer to creditors was directly involved. By the plan, holders of stock in the old company were to receive stock in the new company par for par, upon paying $50 a share, for which they were to receive at par General Mortgage Four Per Cent Bonds of the new company (l. c. 43). Creditors were tendered five per cent preferred stock at par for the full amount of their claims. The court said regarding the creditors' contention: "Their complaint is that they were not paid in full, instead of being offered preferred stock" (l. c. 44). The Court held the offer to be sufficient under the Boyd case, saying:

> "They further lose sight of the fact that the offer made to them in the plan preferred them over common stockholders, and that their relative rights as against the stockholders in the old companies were not changed by the plan, except as to 450 shares of the Iron Mountain, which was too small to seriously affect their interests as proposed by the plan" (l. c. 44).

Phipps v. *Chicago, Rock Island & Pacific Railway Company*, 284 Fed. 945 (C. C. A. Eighth Circuit, decided October 9, 1922; certiorari granted, 261 U. S. 611; dismissed per stipulation, 262 U. S. 762). Phipps had secured a judgment against the Chicago, Rock Island & Pacific Railway Company in a state court, and the suit was for an injunction to prevent his enforcing his judgment by execution against the assets of the company.

Following the judgment in the state court, the District Court in Illinois had, without a foreclosure decree, approved a re-organization plan and attempted to bar all claims against the company. The plan tendered the unsecured creditor interest on his claim at the rate of five per cent up to June 30, 1917 (shortly after the date of the decree, l. c. 946) and six per cent preferred stock at par for the full amount of his claim, to be delivered on July 1, 1917 (l. c. 947). The stockholders were tendered, upon payment of an assessment of $40 a share, seven per cent preferred stock, par for par, in exchange for their old stock, which preferred stock, however, was inferior to the six per cent preferred stock given to the creditors (l. c. 946). The Circuit Court of Appeals held that the District Court had the right to enter the decree without foreclosure and that the claimant was barred by the terms of the decree and could not insist on payment in cash. The fairness of the offer as such was thus perhaps not directly involved. The court, however, undoubtedly considered the offer, because the court says on page 954 that the decree was "fair, equitable and just." Whether the decision is sound in approving the result reached without a foreclosure and in approving the exclusion of the creditor from enforcing his claim against the unmortgaged assets, need not be here discussed.

Mountain States Power Company v. *A. L. Jordan Lumber Company*, 293 Fed. 502 (C. C. A. 9th Circuit, decided October 29, 1923). By a re-organization plan, 23,400 shares of no par value stock were set aside for the satisfaction of unsecured claims. Provision was

made that this stock should first be offered to stockholders at $15 a share. At the time of the sale, however, only 1,532 shares of the entire 23,400 had been sold or taken up by stockholders.

The plan made extensive provision for bondholders, but the opinion does not state what provision was made for stockholders outside of the right to purchase at $15 a share the stock set aside for creditors. It appears, however, that one interest owned about 40 per cent of both bonds and stock (see 286 Fed. l. c. 218) and perhaps it was considered by the court that the stockholders' interest was preserved through the provision made for their bonds. At any rate, the court held that the plan was invalid as against an unsecured creditor, saying:

> "There was here no offer or tender of income bonds or preferred stock, as suggested in the Northern Pacific Case. Of course, the method there suggested is not exclusive, but in our opinion it is exclusive of such a provision as was here made" (l. c. 506).

The corporation involved was not a railroad company, but *was* a public utility company.

(b) Decisions in the District Courts.

So far as we know, there are only two reported cases in the District Courts (treating as one case two reported opinions and one unreported opinion by the same judge growing out of the same re-organization) in which an offer to creditors in connection with a reorganization plan is expressly tested by the doctrine of the Boyd case.

The first is *St. Louis-San Francisco Railway Company* v. *McElvain*, 253 Fed. 123, decided by Circuit Judge Sanborn of the Eighth Circuit. The McElvain case treated as *res judicata* a decree confirming the sale in the St. Louis-San Francisco Railway Company foreclosure case—out of which the McElvain case likewise arose—adjudging sufficient an offer to creditors. An unreported opinion which accompanied this decree and which was relied upon by opposing counsel in the courts below appears at page 495 of the record of this case in the Circuit Court of Appeals and will doubtless be referred to by opposing counsel in their briefs. In this opinion Judge Sanborn made the controlling factors his own judgment as to the value of the property at the time of sale, the improbability of the general creditors receiving anything on a strict foreclosure and the particular facts and circumstances of the case (the creditors were tendered in pursuance of the re-organization plan, 50% of their claims in preferred stock and 50% in common stock).

He said:

> "That is an estimate, but the Court is clearly of the opinion that if the lien holders who foreclosed their mortgage upon this property had proceeded to a sale of the property under their rights, no one could have been found who would have paid enough to satisfy the bonded liens, and there would have been nothing left for either creditors or stockholders. It was, in the opinion of the Court, only by virtue of this reorganization scheme, whereby the stockholders would take hold and assist to reorgan-

ize the company, and to take these new securities, or a portion of them, that anything whatever could have been saved for the common creditors. They never could have bought this property, they never could have reorganized this company, they never could have purchased this property so as to give to themselves anything above the amount required to pay the bonded debt. So that this estimate of three hundred twenty-one millions and this equity of ninety or ninety-one millions, when it comes to an actual foreclosure of the mortgage and the handling of a big property like this, is more imaginary than real. * * * Now, inasmuch as the Court is of the opinion and thinks that there is no doubt that these creditors would have received nothing whatever out of the foreclosure of this property, unless the Reorganization Committee had evolved a scheme or plan whereby this property could be distributed among stockholders and creditors, and would have lost everything, and, *inasmuch as under this offer each creditor is given a larger percentage of his claim in actual value than any stockholder received, the offer cannot be said to be unfair or untimely.* It is an advantage to the creditor to have such a plan or scheme, an advantage from which they derive about 25 per cent of their claims, where, if there had been no such plan or scheme, they would have received nothing."

The McElvain case was followed by Judge Sanborn in *North American Company* v. *St. Louis & San-Francisco Railroad Company*, 288 Fed. 612, 626.

It is thus apparent that Judge Sanborn saw no necessity of preserving the priority of the creditors. He felt that an offer to creditors was sufficient if the

creditor got a little bit more than the stockholder—how much more he would have to get and how the "actual value" should be measured, do not appear.

The argument made by Judge Sanborn is not far from the view expressed by Judge Jenkins in the Paton case, which was expressly disapproved by this Court in the Boyd case. His argument is also quite similar to that of Mr. Francis Lynde Stetson, Counsel for the Railway Company in the Boyd case (l. c. 494). It appears to be opposed to the statement of this Court in the Boyd case that "the invalidity of the sale flowed from the character of the reorganization agreement *regardless of the value of the property,* for, in cases like this, the *question must be decided according to a fixed principle,* not leaving the rights of the creditors to depend upon the balancing of evidence as to whether, on the day of sale the property was insufficient to pay prior encumbrances" (l. c. 507).

The other case was decided by Judge Sanborn's colleague on the Circuit Court of Appeals for the Eighth Circuit—Judge William C. Hook, since deceased (*Guaranty Trust Company* v. *Missouri Pacific Railway Company,* 238 Fed. 812, decided November 28, 1916). This case involved the Missouri Pacific reorganization plan, which was also considered in *Walsh Tie & Timber Company* v. *Missouri Pacific Railway Company, supra,* but the appeal in the Walsh case was taken from a subsequent order, not from the order considered in the Guaranty Trust Company case. In that plan, as will be remembered, the general creditor was given preferred

stock for the entire amount of his claim, whereas the stockholder was entitled to exchange his stock for new common stock on condition that he subscribe and pay for 4% Prior Lien Bonds to the amount of 50% of his stock holdings. The objection to the plan in the Guaranty Trust Company case was by the holders of the bonds of a subsidiary which had been guaranteed by the parent company. The reorganization plan treated these bondholders as general creditors. The court held, first, that, if these bond holders were to be considered as general creditors, the offer was fair, but second, that, on account of their lien on the property of the subsidiary, they were entitled to more than general creditors. The court said with reference to the offer to the general creditors:

> "*The normal relation between the two, general creditor and stockholder, is preserved.* The common stockholder is always last in the scale. Here the general creditor is just before him, and his priority is preserved by preferred stock of the New Company" (l. c. 818).

The fact that Circuit Judges and District Judges have not been unanimous in applying the Boyd case according to its logical conclusion is no argument against that conclusion. There was an even greater lack of unanimity among the judges in the period following the decision of the Howard case, and the decision of the

Monon case.*

(c) Decisions in state courts.

In *Wabash Railway Company* v. *Marshall,* 224 Mich. 593, 600, the Supreme Court of Michigan, relying expressly on the Boyd Case, held that an offer

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*The Boyd case has been cited, but without analytical discussion of the points here involved, in the following cases, (Citations involving only the doctrine of laches not included): *West* v. *Edward Rutledge Timber Company,* 244 U. S. 90, l. c. 96 (1917); *Hamer et al.* v. *New York Rys. Co. et al.,* 244 U. S. 266, l. c. 270; (1917); *Waller et al. Trustees* v. *Texas & Pacific Ry. Co.,* 245 U. S. 398, l. c. 410 (1918); *Southern Pacific Co.* v. *Bogert,* 250 U. S. 483, l. c. 493 (1919); *Ewart* v. *Blue Jacket,* 259 U. S. 129, l. c. 138 (1922); *Mechanics & Metals National Bank* v. *Howell,* 207 Fed. 973, l. c. 980, 983 (1913); *Central Electric Co.* v. *Socorro Electric Co., et al.,* 209 Fed. 534, l. c. 541, (C. C. A. 8th Circuit, 1913); *West* v. *Edward Rutledge Timber Co.,* 210 Fed. 189, l. c. 194, (D. C. Idaho, 1913); *Investment Registry* v. *Chicago & M. E. R. Co.,* 212 Fed. 594, l. c. 610, (C. C. A., 7th Circuit, 1923); *In Re Howell,* 215 Fed. 1, l. c. 7 (C. C. A., 2nd Circuit, 1914); *Equitable Trust Co.* v. *United Box Board & Paper Co.,* 220 Fed. 714, l. c. 719, (D. C. N. J., 1925); *Davis* v. *Virginia Ry. & Power Co.,* 229 Fed. 633, l. c. 641, l. c. 643, (C. C. A. 4th Circuit, 1915); *Vallery* v. *Denver & Rio Grande R. Co.,* 236 Fed. 176, l. c. 181, (C. C. A., 8th Circuit, 1916); *Blue Ridge Electric Co.* v. *American Bank Note Co.,* 237 Fed. 755, l. c. 762; (C. C. A., 5th Circuit, 1916); *Equitable Trust Co. of New York* v. *Western Pac. Ry. Co.,* 244 Fed. 485, l. c. 505 (D. C. New York, 1917); *Okmulgee Window Glass Co.* v. *Frink,* 260 Fed. 159; l. c. 162, 167, 168, (C. C. A., 8th Circuit, 1918); *National Circle, Daughters of Isabella* v. *National Order of Daughters of Isabella,* 270 Fed. 723, l. c. 732, (C. C. A. 2nd Circuit, 1920); *Oehring* v. *Fox Typewriter Co.,* 272 Fed. 833, l. c. 835, (C. C. A.,

to general creditors made under the Wabash re-organization plan, which tendered to creditors 25 per cent of their claims in preferred stock and 75 per cent in common stock, was not sufficient to bar the claim of a non-assenting creditor to be paid in cash.

6th Circuit, 1921); *Plews* v. *Burrage,* 274 Fed. 881, l. c. 888 (C. C. A., 1st Circuit, 1921); *Ozan Lumber Co. et al.* v. *Davis Sewing Machine Co., et al.,* 284 Fed. 161, l. c. 165, (D. C. Delaware, 1922); *Bogert et al.* v. *Southern Pacific Co.,* 285 Fed. 46, l. c. 47 (D. C. New York, 1922); *Taylor* v. *Salt Creek Consolidated Oil Co.,* 285 Fed. 532, l. c. 537, (C. C. A. 8th Circuit, 1922); *Mountain States Power Co.* v. *Jordan Lbr. Co.,* 286 Fed. 217, l. c. 221, (D. C., Montana, 1923); *Cashman et al* v. *Hitchcock,* 293 Fed. 958, l. c. 961 (C. C. A., 1st Circuit, 1923); *Safety Car Heating & Lighting Co.* v. *United States Light & Heating Co.,* 2 F. (2d), 384, l. c. 386, 388 (D. C. New York, 1924); *Flemming* v. *Taylor Fuel, Light & Power Co.,* 90 Kan. 763, l. c. 774; (1913); *Jennings, Neff & Company* v. *Crystal Ice Co.,* 128 Tenn. 231, l. c. 242; (1913); *Zwietusch et al* v. *Luehring et al.,* 156 Wis. 96, l. c. 117; (1914); *Pittsmont Copper Co.* v. *O'Rourke.* 49 Mont. 281, l. c. 293, 303; (1914); *Smythe* v. *Central Vermont Ry. Co.,* 88 Vt. 59, l. c. 69; (1914); *Clark* v. *Bankers' Trust Co.,* 163 N. Y. S. 748, l. c. 755, (1917); *Clark* v. *Bankers' Trust Co.,* 177 N. Y. App. Div., l. c. 634, 164 N. Y. S. 544, l. c. 549, (1917); *Male* v. *Atchison, Topeka & S. F. R. Co.,* 197 N. Y. App. Div. 88, l. c. 89, 91, 94, 105; 166 N. Y. S. 593, l. c. 594, 596, 597, 605, (1917); *Sweeney* v. *O'Brien Mining Co.,* 194 Mo. App. 140, l. c. 149, l. c. 150, l. c. 151, (1916); *Burnwell Coal Co.* v. *Setzer,* 203 Ala. 395, l. c. 397; (1919); *Male* v. *Atchison, Topeka & Santa Fe Ry. Co.,* 230 N. Y., 158, l. c. 166; (1920); *Johnson* v. *United Rys. Co. et al,* 281 Mo. 90, l. c. 163; (1920); *Ballew Lumber Co.* v. *Missouri Pacific Railway Co.,* 288 Mo. 473, l. c. 478; *Hughes* v. *City Trust Co.,* 151 La. 313, l. c. 328.

The rights of railroad creditors ought to be determined by a definite principle of equity modifying as little as possible ordinary principles of equity, and not by the unguided opinion of the chancellor as to what constitutes a sufficient offer.

Equity is a system of jurisprudence, not a set of ideals to be applied according to the moral conceptions of the judges who happen to be in office.

> "The court, therefore, will entertain jurisdiction of the cause, but will exercise that jurisdiction in conformity with the settled principles of a court of chancery" (Mr. Chief Justice Marshall, in *Bodley* v. *Taylor*, 5 Cranch 191, l. c. 223).
>
> "The hardships of a particular case would not justify this tribunal in prostrating the fundamental rules of a court of chancery" (Mr. Chief Justice Marshall in *Crocket* v. *Lee*, 7 Wheat, 522, l. c. 527).
>
> "The rules of equity are as fixed as those of law, and this court can no more depart from the former than the latter" (Mr. Justice Swayne in *Wright* v. *Ellison*, 1 Wall. 16, l. c. 22).

See also *Fontain* v. *Ravenel*, 17 How. 369, 395; *Rees* v. *Watertown*, 19 Wall. 107, 122.

> "The cases which occur are various; but they are decided on fixed principles. Courts of equity have, in this respect, no more discretionary power than courts of law. * * *
>
> "But the principles are as fixed and certain as the principles on which the courts of common law proceeded" (Lord Redesdale in *Bond* v. *Hopkins* 1 Sch. & Lefr. 428, quoted in Story, Equity, 14th Ed. Sec. 20).
>
> "In short, if a court of equity in England did really act as many ingenious writers have supposed it (from theory) to do, it would rise above all law, either common or statute, and be a most arbitrary legislator in every particular case" (Story, Equity,

Sec. 19, quoting from Blackstone's Commentaries).

> "Nor would a chancellor at the present day assume to decide the facts of a controversy according to his own standard of right and justice, independently of fixed rules—he would not attempt to exercise the *arbitrium boni viri*" (Pomeroy, Equity Jurisdiction, 3rd Ed., Sec. 47).

The decision in the Boyd case was but an application of the principles of equity laid down in the Howard case and the Monon case, and later enforced in the Pierce case. The Court, however, recognized the practical necessity of permitting stockholders to participate in railroad reorganizations, and, by a *dictum*, clearly indicated that these principles of equity would have to be modified to meet the practical necessities of the situation and the public interests involved. The Court thus relaxed principles, equitable enough in ordinary cases, but inequitable in railroad foreclosures, if literally applied.

The principles were not destroyed, however. They were merely modified by the establishment of a new principle of equity. This new principle does not delegate an unbounded discretion to the chancellor, any more than did the old ones. It establishes a new but definite standard of measurement.

The Court had previously modified ordinary equitable principles for similar reasons; once, in the matter of preferred claims for operating expenses (*Fosdick* v. *Schall*, 99 U. S. 235), and, again, in the matter of receivers' certificates issued for the continued operation of railroads (*Union Trust Company* v. *Illinois Midland Railway Company*, 117 U. S. 434).

In each case, the relaxation of the rule went only so far as the necessity, and this Court has had occasion to restrict sharply the growing tendency to determine such matters without fixed principle, but according to the personal discretion of the chancellor (*Wood* v. *Guaranty Trust Company*, 128 U. S. 416, *Kneeland* v. *American Loan and Trust Company*, 136 U. S. 89; *Gregg* v. *Metropolitan Trust Company*, 197 U. S. 183. See also *Hanna* v. *State Trust Company*, 70 Fed. 2, C. C. A. 8th Circuit, and *Smith* v. *Shenandoah Bank*, 246 Fed. 379, C. C. A. 4th Circuit).

The doctrines just referred to apply only to railroads (or possibly in some respects to other public utilities); and the relaxation of the ordinary principles of equity effected by the dictum in the Boyd case is likewise so limited.

What the Court says in the Boyd case about determining the validity of the sale (and hence, whether *any* provision must be made for creditors) is in precise accord with what we have said and applies with equal force to determining *what* provision must be made for creditors. "The question must be decided *according to a fixed principle*, not leaving the rights of the creditors to depend upon the balancing of evidence," (l. c. 507). And that fixed principle must be determined with the same careful regard for the reason for relaxing the ordinary rule and with the same rigid limitation to the necessities of the case and of the public interest exemplified in the decisions of this Court dealing with preferred claims and receivers' certificates.

The necessity here arises from the desire of the bondholders to secure the co-operation of the stockholders, rather than their opposition, and from the usefulness of additional cash in putting the new corporation on its feet. As the court says in the Boyd case: "A combination is necessary to secure a bidder and prevent a sacrifice. Co-operation being essential, there is no reason why the stockholders should not unite with the bondholders to buy in the property" (l. c. 504). The same idea is expressed in different language by a distinguished and experienced lawyer in a monograph on re-organizations, Mr. Paul D. Cravath:

> "But still in most large re-organizations, the stockholders knock loudly at the door for participation, and it is still the preference of most bondholders' committees to afford them participation, partly to avoid the dissatisfaction, litigation and delay which might result from their exclusion, and partly to secure new capital by appealing to the desire of stockholders to retain their interest in the property and their consequent willingness to furnish new capital on more favorable terms than could be obtained from strangers" (Some Legal Phases of Corporate Financing, Re-organization and Regulation, by Francis Lynde Stetson, Paul D. Cravath and others, The MacMillan Company, 1922, page 195).

The stockholder, of course, ought to have a speculative chance of making something by his participation, and the creditor, under the liberal rule of the Boyd case, may be asked to *defer* his rights to give the stockholder that chance. But he cannot be asked to sacrifice them or to enter into a speculation with the stockholder. He must be assured that, if he waits long enough, he will

get his principal in full, either through the prosperity or the liquidation of the corporation, before the stockholder gets anything—and that, while he is waiting, he will get a return on his principal before the stockholder gets any income. Of course, if the re-organized company fails, he may get nothing or very little. But he must get that little before the stockholder gets anything. He must necessarily take a chance on the success of the re-organization, but he has a right to know that he is ahead of the stockholder. He cannot be compelled to run a race with the stockholder to see whose securities will have the highest quotations on the New York Stock Exchange. Equitable rights cannot be made to depend on any such widely fluctuating standard.

There is nothing in the language of the Boyd case which lends any color to the theory that the creditor must be satisfied if he gets slightly more securities than the stockholder, but without priority. On the contrary, the plain implication is that he is entitled to retain his rank, but that he cannot require cash, if his rank is preserved to him in securities. The Court says: "His interest may be *preserved*," and the language which immediately follows indicates that it is the creditor's *priority* which is to be preserved, rather than the empty shell of his claim—"by the issuance on equitable terms of income bonds or preferred stock" (l. c. 508).

The same idea is clearly implied in the Monon case:

> "We observe that no such proceedings" [foreclosures] "can be rightfully carried to consummation which recognize and preserve *any* interest in the stockholders without also recognizing and *preserving* the interests not merely of the mortgagee,

but of every creditor of the corporation. In other words, if the bondholder wishes to foreclose and exclude inferior lien holders or general unsecured creditors and stockholders, he may do so, but a foreclosure which attempts to preserve any interest or right of the mortgagor in the property after the sale must necessarily secure and *preserve* the *prior* rights of the general creditors thereof" (174 U. S. l. c. 683, 684).

Thus, "The *normal relation between the two,* general creditor and stockholder, *is preserved.* The common stockholder is always last in the scale. Here the general creditor is just before him, and *his priority* is preserved by preferred stock of the New Company" (*Guaranty Trust Company* v. *Missouri Pacific Railway Company,* 238 Fed. l. c. 818).

That there is no paramount necessity to relax the general rule of equity so far as to depart from all fixed principles and leave the whole question to the unregulated discretion of the Chancellor, is demonstrated by the fact that the two largest railroad re-organizations of recent times have been carried through in literal compliance with the fixed principle which we support—the Missouri Pacific and the Rock Island (280 Fed. 38, 44; 284 Fed. 945, 948)— and that these two companies are today highly successful and prosperous and among our largest systems.

Any rule, which, instead of preserving the creditor's rank over the stockholder, makes him take the same or similar grade of securities as the stockholder in equal or slightly greater amounts, compels the creditor to make a sacrifice. It means that a court of equity, instead of requiring him to *defer* his claim, compels him

to share his claim with his own debtor. The vagaries of the stock market might even produce a situation by which the stockholder, either through good luck or superior familiarity with the fluctuations of the market, would actually realize more than the creditor.

A court of equity has no "unlimited discretion" to destroy or reduce the creditor's claim, any more than it has to displace vested liens (see *Kneeland* v. *American Loan and Trust Company,* 136 U. S. l. c. 99). It cannot take the creditor's property and hand it over to the stockholder. It may require the creditor to wait (or lose, if the enterprise fails), but the stockholder must always have to wait longer (or lose first).

Mr. Justice Brewer in *Merchants Loan & Trust Company* v. *Chicago Railways Company,* 158 Fed. 923 (C. C. A. 7th Circuit) held that a court of equity administering a receivership could not subordinate a mortgage lien to a new mortgage to be executed by a new company to be formed under a re-organization plan—even though all parties were before the court—however great the advantage to the property and to the supposed interests of the parties. Mr. Justice Brewer said:

> "Now, that may be a wise business proposition, and, if the Court had power to take hold of these things and do for the people, who are mortgage bondholders, that which it thinks best for them, we might have no hesitation in sustaining this; but every man in this country decides questions in respect to his own property for himself" (l. c. 929).

The result would have been the same, had the plan provided equality for the new mortgage instead of superiority.

The general creditor has a vested interest. The chancellor cannot destroy or impair it, except in accordance with equitable principles, any more than he can destroy or impair the bondholder's vested interest. He cannot—merely because he thinks it a good business proposition, or even because he thinks it to the advantage of the creditor—require the creditor to accept either inferiority to or equality with the stockholder, over whom he has a vested right to priority (Cf. *In re Prudential Outfitting Company,* 250 Fed. 504).

Furthermore, if the rule were that the creditor must be satisfied with securities of the same grade and rank as the old stockholder, *how much* more must the creditor be offered? If it is enough that he get one-third of his claim in preferred stock and the rest in common, why is not one-twentieth in preferred enough? Or, if he is offered participation on the same terms as a stockholder, but permitted to pay $2 less per $100 for his bonds, why cannot he not be required to accept such participation upon payment of only 2 cents less for his bonds. If he cannot be required to accept these extreme propositions, where is the line to be drawn? By what percentage must his participation exceed the stockholder's in quantity or value? What is the "fixed principle" by which the creditor's rights in such cases are to be determined?

Suppose a plan of re-organization provided that the creditors should be offered twenty-five cents on the dollar in cash and that the stockholders should be paid twenty cents or fifteen cents for every dollar of par value of stock, would anyone contend that such a plan

would be good under the Boyd case? Would not the creditor be entitled to say to the stockholder: "If there is only forty or forty-five cents left for both of us, I am entitled to all of it, because I am prior to you." And yet, what is the difference in principle between such a plan and that contended for by opposing counsel? In each case, the creditor gets a little more than the stockholder, but his priority is not preserved.

This Court in the Boyd case and the Monon case, did not say that a *part* of the creditor's interest must be preserved, but the plain implication is that if *any* interest of the stockholder is preserved, then *all* the interest of the creditor must be preserved. To preserve is to "keep intact or in existence" (Webster). *All* of the interest of the creditor is not preserved by giving him a fraction of his claim in cash, nor by giving him securities which are, in whole or in part, of the same rank as those given the stockholder. *All* of the interest of the creditor *is* preserved, if he is given securities which, for the full amount of the creditor's claim, rank ahead of the securities received by the stockholder—even though the creditor may thereby be compelled to *defer* realizing upon his claim.

It will doubtless be argued that the creditor may sometimes get more in market value by a mixed offer than he would by taking a preferred security. It is difficult to see how this could be the case, unless the interest or dividend on the preferred security were purposely and in bad faith made excessively low in order to depress its value. But, even if under normal conditions the result suggested should follow, the answer is that

the creditor, then, should have his choice to take the mess of pottage in place of his birthright. He should not have his birthright taken away and the delectable pottage substituted by someone else. He should be given the option to take his preferred security or the more speculative participation. As Mr. Justice Brewer said in *Merchants Loan and Trust Company* v. *Chicago Railways Company*, 158 Fed. 923:

> "Although it," [the Court] "may believe that a party insisting upon those rights" [his strict legal rights] "is probably, or even certainly, bound to suffer loss, yet while he insists it must protect him in his insistence" (l. c. 927).

It will not do to say that it is impracticable to preserve the normal relation between creditor and stockholder, or, as Judge Jenkins said in the Paton case, with reference to requiring *any* provision for the general creditor:

> "If such conclusion results from the decision in the Howard Case, the result must prove disastrous, uprooting past re-organizations of great magnitude, and seriously crippling, if not preventing, any future re-organization of bankrupt corporations" (85 Fed. l. c. 840).

The dire results predicted by Judge Jenkins have not followed, and that they will not follow from applying the rule in the Boyd case according to its intent is demonstrated by past history. As early as 1882, the income bond method was successfully applied (*Hancock* v. *Toledo etc., R. Co.*, 11 Biss. 148, 9 Fed. 738), and the preferred stock method has been successfully followed, as we have noted, in the two largest railroad re-or-

ganizations of recent years, the Missouri Pacific and the Rock Island (280 Fed. 38; 284 Fed. 945).

That the rights of the creditor must be determined by a fixed principle is clear, and the only fixed principle which is at all consistent with previously existing principles of equity is that with requires the priority of the creditor to be preserved. In fact, no one has attempted to suggest any other principle which does not resolve itself into an exercise of "unlimited discretion" by the chancellor and his fellow judges on appeal.

The rule which requires the preservation, in the re-organization, of the normal relation between the general creditor and the stockholder not only is more consonant with general equitable principles and with the need for a "fixed principle" expressed in the Boyd case. It is more convenient in practical operation. It lets re-organization managers know in advance what they can do, and it lets creditors know what their rights are and what they are not. Many general creditors in the past have sacrificed their rights through not knowing what they were, or not being willing to spend the money to enforce them. The history of the Boyd case and of the Kansas City Southern case illustrate the superhuman perseverance of those creditors who have insisted on their rights. If the rule suggested by the Boyd case, that the normal relation between general creditors and stockholders must be preserved through the re-organization, is firmly established, then there need be no further litigation. "He who runs may read."

Under the other rule, re-organization managers will be under a constant temptation to whittle the creditors'

participation down to the lowest percentage over the stockholders' participation which they think the particular chancellor in charge of the foreclosure will approve. And some chancellors, proud of a successful receivership administration and eager for an equally successful re-organization to result, will, perhaps, be unduly impressed by the idea that the re-organization will be hampered if the creditors are given too much. In any event, the chancellor will be compelled to make a general finding as to whether the offer is "fair," without any rule whatever to guide him. And thus, unless this Court firmly establishes a fixed principle to be followed by courts as well as parties, the liberal but wholesome dictum of the Boyd case may become a meaningless phrase, and the rights of creditors made to depend, not on a fixed principle of equity, but upon an individual's idea as to whether the creditors have been fairly treated, or, in the language of the Circuit Court of Appeals in presenting the questions now before the Court, whether "the offer tenders to such creditors all that could reasonably be expected under all of the existing circumstances."

The creditor, under such a rule, would face an impossible task. He would have to investigate the entire history of the receivership, foreclosure and re-organization, the whole financial structure of the company, and the values of all its properties—involving an expense, enormous even to organizations of security holders, and prohibitive to the individual general creditor. After all this had been done, he would, perforce, have to submit the evidence to a chancellor, who must determine from

it whether the creditor had been "fairly" treated, and neither the creditor nor the chancellor would have any standard by which fairness or unfairness could be determined. As a practical matter, the creditor would have to take what was offered him, whatever he might think of the fairness of the offer. He could not hazard his entire claim on a guess as to what the chancellor might consider "fair."

The need of a *fixed principle* by which the rights of the parties can be determined is forcibly expressed by Mr. Paul D. Cravath in his monograph on re-organizations above referred to:

> "It must earnestly be hoped that before long the Supreme Court will have an opportunity of handing down a decision which will supplement its decision in the Boyd Case, by indicating some fixed principles to be applied in making provision for the floating debt in re-organizations based upon the foreclosure of mortgages which offer participation to stockholders" (Some Legal Phases of Corporate Financing, Re-organization, and Regulation, p. 197).

The issuance of this certificate by the Circuit Court of Appeals for the Eighth Circuit Court implies the same hope.

Effect of Assessment.

Question III propounded by the Circuit Court of Appeals contains as an hypothesis the payment of an assessment by the stockholder.

What is meant by an assessment and what is its effect?

In the Boyd case, holders of preferred stock were assessed $10 a share and holders of common stock $15 a share, and they got nothing for the assessments except the right to participate in the re-organization by exchanging their old stock for new stock (l. c. 489). The payment of these assessments did not affect the Court's conclusion in any way. As Mr. Cravath says, with reference to the Boyd case in the monograph already referred to:

> "The moment they provided for participation in the new company by the stockholders, even at the price of paying a heavy assessment, the obligation arose to make provision for the unsecured debt which would recognize its priority to the interest of the stockholders" (p. 193).

In most cases, however, the "assessment" is not really an assessment at all, because the stockholder gets for it bonds or other preferred securities to the full amount of his payment.

To quote Mr. Cravath again:

> "I have used the term 'assessment' as describing the payment required of stockholders and others interested in the equity as a condition to their participation in a re-organization, because it is the term commonly used. It is, however, inaccurate, inasmuch as on final analysis the opportunity offered is to purchase from the Committee a portion of the securities which are to be issued to it by the new company in return for the property acquired and for the cash provided under the plan. It is simply a sale of securities" (p. 183).

And Judge Hook says in *Guaranty Trust Company* v. *Missouri Pacific Railway Company*, 238 Fed. 812:

> "In this case the old stockholders are required to pay in cash 50 per cent of the par of their holdings. They will receive for their cash payments new 4 per cent bonds at par. In order, these bonds will come just ahead of the preferred stock. They will be inferior to all the other bonded indebtedness, and their subordinate position in that respect, and their rate of interest, taken together, make it doubtful that they will soon, if ever, be worth par. *This will operate as an assessment upon the common stock to the amount of the discount.* That the stockholders will be given bonds for their cash payments is not inequitable to general creditors. They will pay more than they will get in value; but if they paid nothing, and received no bonds, still the relation between them and general creditors would not be disturbed" (l. c. 818).

In the case at bar, the holders of the preferred stock of the old company paid $20 a share and received $14 in Prior Lien 6% Bonds and $6 in Adjustment Mortgage Bonds, and the holders of common stock, $25 a share, for which they received $17.50 in Prior Lien 6% Bonds and $7.50 in Adjustment Mortgage Bonds—in each case, bonds to the full amount of the cash payment (Certificate, p. 2). They were assessed, therefore, only to the extent that what they paid for was worth less than par. A reference to the bond quotations on the New York Stock Exchange will show that the Prior Lien 6% Bonds since the first of the present calendar year (February 1st, 1926) have sold as high as 104⅛ and the Adjustment Mortgage Bonds as high as 95. While they were doubtless worth less at the time of their issuance, it is apparent that the stockholders did not sacrifice much in buying the bonds. In fact one who held them and sold at the prices quoted would have made a small profit.

In this case even more than ordinarily, therefore, the assessment can be ignored. It is never important, except as it reduces the participation of the stockholder, and, in this case, it reduced his participation very little.

On the other hand it may be, as indicated by Judge Hook, that the fact that the stockholder gets for his cash payment a security which is prior to the security given the general creditor does not invalidate the offer to the latter, *provided* the prior security is sold to him in good faith for full value not less than par and is not merely used as a subterfuge to give him a priority over the creditor, by reason of his being a stockholder of the old company.

Offer in Missouri, Kansas and Texas Reorganization.

The Re-organization plan and the offer in this case, as set forth in the certificate, (Certificate, pp. 2, 3), illustrate our argument very aptly.

The stockholders of the old company were called upon to pay as a condition of participation:

Owners of preferred stock, $20. per share,

Owners of common stock, $25. per share.

Each stockholder was entitled to receive upon surrendering his old stock and making the above payment—Holder of preferred stock for each share—

$14. in Prior Lien 6% Bonds,

$ 6. in Adjustment Mortgage Bonds,

1 Share of Common Stock.

Holder of common stock for each share—

$17.50 in Prior Lien 6% Bonds,

$7.50 in Adjustment Mortgage Bonds,

1 Share of common stock.

Creditors were offered—

Offer "A"—

For each $100 of claim: One-third of a share of preferred stock par value $100. a share, and two-thirds of a share of common stock.

Offer "B"—

For each $100. of claim: $14. in Prior Lien 6% Bonds, $6. in Adjustment Mortgage Bonds and one share of common stock, but only upon payment of $18.

The stockholder thus exchanged his stock for new stock upon condition that he should pay a certain amount of cash, for every dollar of which, however, he secured at par a lien prior to the creditor's interest.

The creditor got, for his claim, either (a) one-third preferred stock and two-thirds common stock, or (b) the privilege of participating in exactly the same manner as the holders of preferred stock, except that he had to pay $18 per $100 of claim for the privilege, instead of the $20 paid by the stockholder.

Let us compare Offer A with the provision for stockholders:

OFFER A—

Each general creditor of the old company gets one-third of a share of preferred stock and two-thirds of a share of common stock in the new company for each $100 of the amount of his claim. Each holder of one

share of the preferred stock of the old company gets one share of common stock of the new company, and each holder of one share of the common stock of the old company likewise gets one share of common stock of the new company. Hence, the general creditor is preferred over the holders of the preferred and common stock of the old company as to one-third of the amount of his claim, *but as to two-thirds of the amount of his claim the general creditor is not preferred* but stands upon an equal footing with the holders of the preferred and common stock of the old company. Thus, as to two-thirds of the amount of the general creditor's claim, the old stockholders have been promoted by the reorganization plan from their former position of inferiority to the creditor to a standing of equality with the creditor in the new company. Formerly, the general creditor was superior in right and prior in lien to all the stockholders of the old company as to the entire amount of his claim. By the reorganization, the creditor has lost this superiority and priority as to two-thirds of his claim, and, what he has thus lost, the stockholders of the old company have gained.

The fact that the stockholders of the old company are required to pay certain amounts as conditions to their participation is no justification for their being advanced to a position of equality with the general creditor. For every dollar of their so-called assessments, the stockholders have been given bonds of equal par value, which, through their lien, preserve to the stockholders an interest in the assets of the new company prior to everything which the creditor gets in the reorganization.

Lest it be thought that, by the assessment, the stockholder has added something to the assets of the company, to which the creditor as a stockholder in the new company may resort, it should be observed that, through his bonds, the stockholder has preserved a right in himself to resort to the assets ahead of the creditor to the amount of every penny of the assessment which he has paid. It is true that, by the assessment, the stockholder has added something to the assets of the new company, but through the bonds, he has carefully preserved all these additional assets for himself. He has reserved the right to take back what he has given, thus leaving nothing to which the creditor, as a stockholder in the new company, can resort.

OFFER B.

Boiled down, this offer means that the creditor would get $20 par value of bonds for $18. The holder of preferred stock would get precisely the same thing but he would have to pay $20 for it, instead of $18. In other words, the creditor has the advantage to the extent of 2% of his claim. The holder of common stock pays $7 more than the creditor, but he get $5 more in bonds than does the creditor. So that the spread between the creditor and the holder of common stock is but very little more than that between the creditor and the holder of preferred stock. Furthermore, Offer B involves the payment of money by the creditor as a condition precedent to the preservation of any part of his interest. An arrangement which makes the payment of money by the creditor a condition precedent to his participation

and at the same time preserves the stockholder's interest obviously cannot affect the creditor's rights. A creditor cannot be required to pay for the privilege of having his interest preserved as against the stockholder's. As an offer Offer B is a nullity.

It is apparent from these comparisons that the "normal relation between the two, general creditor and stockholder" is not preserved. Under Offer A, the creditor is preferred as to only one-third of his claim. Under Offer B, he is not preferred at all; he is merely given the same participation as the stockholder upon slightly better terms. Offer B is invalid, because it attempts to make the creditor's interest conditional upon his paying something to preserve it, while the interest of the stockholder is preserved; and both offers are invalid, because the normal relation between creditor and stockholder is not preserved.

To determine the comparative worth of the respective provisions for creditors and stockholders on the basis of these offers, would require a hearing in regard to values, a consideration of market reports on various dates, and difficult questions as to what date should govern, the presence or absence of manipulation, the value of the property back of the stock—in fact, all the questions which this Court in the Boyd case said that the creditor ought not to have to go into.

"Generally the objection to a plan of reorganization should involve a definite principle, and not require a long complicated investigation of values, properties, etc." (238 Fed. 818). So the principle on which an offer to creditors under a reorganization plan is based

ought to be so definite that the creditor does not have to institute a "long complicated investigation of values, properties, etc."— for him an impracticable, if not impossible task, as we have seen.

The certificate does not state the market prices of the securities of the new M-K-T Company. But it is obvious that, whatever they were, they would probably fluctuate widely from one date to another, and that comparisons would differ according to the date selected for comparison.

Even after the difference in value between what the creditor got and what the stockholder got had been ascertained, however, the court would have no fixed principle by which to determine whether the creditor had gotten what he was entitled to. Must he get 1%, 2%, 10%, 20%, 40%, 50%, 75%, 90% or 100% more than the stockholder? The chancellor could only try to guess whether, in the language of Questions II and III, "the offer tenders to such creditors all that could be reasonably expected under all of the existing circumstances."

In *Wabash Railway Company* v. *Marshall*, 224 Mich. 593, an offer to creditors in the Wabash reorganization, very like the offer in the M. K. & T. reorganization (25% preferred stock and 75% common stock) was held insufficient under the Boyd case.

Interest.

It will also be argued that the offer in the instant case is particularly meritorious, because it includes a certain amount of interest for the creditor. The interest included was up to a date about six months before

the entry of the foreclosure decree and over a year before the conveyance of the property to the new company (Certificate, p. 3).

The inclusion of interest was no more than the creditor's right. In fact, it was a little less. He was entitled to interest at least to the date when he could receive his securities under the offer (See *Phipps* v. *Chicago Rock Island & Pacific Railway Company,* 284 Fed. 945, 946, 947).

Since the case of *American Iron Company* v. *Seaboard Air Line Railway,* 233 U. S. 261, it is settled that the rule stopping interest on the appointment of a receiver is one of convenience, only, to facilitate distribution among creditors of the same class, and that it has no application to controversies between those of superior and inferior rank. As against the corporation and its stockholders, the creditor, as a matter of right, can insist upon interest in full. The Court says:

> "But that is not because the claims had lost their interest-bearing quality during that period, but is a necessary and enforced rule of distribution, due to the fact that in case of receiverships the assets are generally insufficient to pay debts in full. * * * For that and like reasons, in case funds are not sufficient to pay claims of equal dignity, the distribution is made only on the basis of the principal of the debt. But that rule did not prevent the running of interest during the Receivership; and if as a result of good fortune or good management, the estate proved sufficient to discharge the claims in full, interest as well as principal should be paid" (l. c. 266).

The general rule is thus stated by a distinguished text writer (II Tardy's Smith on Receivers, 2nd Ed. Sec. 598):

> "As against the receivership debtor, and, in case of a corporation *as against the corporation* itself *and its stockholders*, all creditors are entitled to be paid in full with interest to the time of payment and will be so paid if the funds are sufficient."

Furthermore, in the reorganization involved in *Hancock* v. *Toledo, etc. R. R. Co.*, 11 Biss. 148, 9 Fed. 738, the amount for which income bonds were issued to the general creditors included interest in full, and, in the Rock Island reorganization (*Phipps* v. *Chicago, Rock Island and Pacific Ry. Co.*, 284 Fed. 945, 946), interest up to the date for delivery of securities was paid in cash. The report of the Missouri Pacific Case (280 Fed. 38) does not state whether interest was included. Whether it was or not, the appellants in that case did not raise the point.

The reorganization managers in the case at bar, therefore, have conferred no favor upon the creditors by permitting a certain amount of interest to be included in the computations upon which securities were to be issued under the offer to creditors.

Conclusion.

We submit that the only sound rule is the one which requires the offer to general creditors to preserve the creditors' rank over the stockholders by some form of

security which has priority over the stockholders' interest, both as to principal and income.

(1) It involves the least departure from the ordinary equitable principles that a voluntary transferee, a mortgagor buying at his own sale, or an owner buying in at a tax sale takes the property purchased subject to all claims against it.

(2) It is in accord with the spirit of the Boyd case and also with the language of the Boyd case so far as the latter goes.

(3) It establishes a "fixed principle" by which the fairness of an offer may be determined. Any other rule leaves the question to be determined more or less according to the whim of the individual chancellor administering the property.

(4) It makes for uniformity.

(5) It enables reorganization managers to know what they can do and it enables creditors to know what are their rights.

(6) It is a thoroughly practical rule, tested in important railroad reorganizations.

(7) It is fundamentally sound and just.

The Questions.

If our argument is sound, it follows that all three questions ought to be answered in the negative, but, perhaps, with the qualification as to Question I: "except that the stockholder may have precedence over the credi-

tor so far only as he shall receive prior lien securities, for which, by way of assessment or otherwise, he shall have subscribed and paid full value, not less than par."

We respectfully urge that they be so answered.

Respectfully submitted,

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